No. 15,334

IN THE

United States Court of Appeals

For the Ninth Circuit

LUCKY LAGER BREWING COMPANY,
a corporation,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

On Review of The Tax Court of the United States.

PETITIONER'S REPLY BRIEF.

RUSSEL SHEARER,
One Montgomery Street, San Francisco 4, California,
ARTHUR H. KENT,
VALENTINE BROOKES,
1720 Mills Tower, San Francisco 4, California,
Counsel for Petitioner.

ROBERT H. HEEB,
One Montgomery Street, San Francisco 4, California,
Of Counsel.

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PETITIONER'S REPLY BRIEF.

A. ALTHOUGH THE LITERAL WORDS OF THE STATUTE DO NOT COMMAND SUPPORT OF HIS POSITION, RESPONDENT HAS BASED HIS ENTIRE CASE ON THEM, IGNORING THE PRINCIPLE THAT EVEN LITERALNESS MUST GIVE WAY TO A REASONABLE RESULT CONSONANT WITH THE PURPOSE AND INTENDED EFFECT OF A STATUTE.

1. Anyone familiar with this case must wonder what position respondent will adopt concerning retail sales taxes, and other taxes which in accounting practice are customarily omitted from reported gross sales.

Consider a retailer in California. It pays a sales tax to the State and others to cities. It adds something to the price of the articles it sells to its customers in order

to obtain reimbursement for the sales tax, and its actual reimbursements may be either more or less than the sales tax payable (R. 41). The retail sales tax payable is customarily excluded by retailers from their reports of income, so the amount of retail sales taxes paid will not appear in the reported gross receipts or gross sales (R. 40-41).

What is to be done with these retail sales taxes? Is the Internal Revenue Service to include them in "gross receipts" for purposes of determining growth, even though they appear nowhere in the base period income tax returns? The Tax Court said yes. It said the character of the excise tax was not determinative (R. 42), that gross receipts included "everything received by the corporation in its own right" (R. 47).

Respondent should support the Tax Court in this. And in the summary of argument he would appear ready to do so, for he says (Resp. Br. 12):

> "Whatever amounts taxpayer added to its sales price because of the tax were paid by the purchasers to get the beer and for nothing else."

Since customers pay retailers an element of retail sales tax reimbursement in order to get the goods retailers sell, what respondent says of the beer excise taxes is of equal application to the retail sales taxes, so one would expect respondent to argue for the inclusion in "gross receipts" of retail sales taxes reimbursements.[1]

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[1]The same implication appears in the following remark by respondent (Resp. Br. 14):

> "As the Tax Court stated (R. 48), taxpayer could pass on the economic burden of the taxes but the tax liability was its own."

Our opening brief assumed that respondent would accept and defend the Tax Court's view in this respect, and we argued on that premise. Of course, while that court's interpretation would avoid the difficulty of construing the statutory term "gross receipts" to mean one thing when retail sales taxes are concerned and something different when beer excise taxes are involved, it does greatly magnify the lack of uniformity which flows from the decision below. See Pet. Op. Br. pp. 35-39, inclusive.

But if respondent agrees with the Tax Court that the result is the same whether sales taxes or other types of excises are involved, why does he argue that the beer excise tax is not a sales tax? See Resp. Br. 11, 23, 24. And why does respondent attempt to distinguish the cases on which we rely for the proper interpretation of "gross receipts" on the ground that they involved sales taxes and not beer excise taxes (Resp. Br. 23-24)? The Tax Court thought it made no difference. Does respondent disagree with the court he seeks to sustain?

We can, however, meet respondent on the ground he now appears to be choosing. The federal beer excise tax is a sales tax.[2] The statute[3] imposed the tax on "all beer . . . *brewed or manufactured and sold, or removed for consumption or sale,* within the United States . . ." (Emphasis added.) The effect of the double requirement that the beer taxed be both manufactured and sold in

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[2]Inasmuch as it was the 1939 Internal Revenue Code which was in effect in the years 1946-1949, the base period, our discussion will be entirely in the light of its provisions.

[3]Sec. 3150, 1939 I.R.C.

the United States was to exclude from the tax both imported beer, which was subject to a customs duty (Tit. 19, USCA, Sec. 1001, Par. 805), and exported beer, which had to compete in foreign markets. Beer produced in the United States was taxed if sold in the United States, and was taxed when sold or removed for sale.

The beer excise tax thus follows the pattern of federal excise taxes. Compare, for example, Section 3412, which imposes a gallonage tax "on gasoline sold by the producer". Again, unless there is a producer (manufacturer) there is no tax, but also there is no tax unless there is a sale. Yet respondent would distinguish cases excluding collections on account of the federal gasoline tax on the ground it, but not the beer tax, is a sales tax. (Resp. Br. 23.)

The fact is that the standard federal excise tax, found in a chapter of the Code denominated "manufacturers' excise taxes", is a sales tax, because the tax does not arise until and unless the product is sold. Sections 3400(a), 3401, 3403-3409, inc., 1939 Code. None of these sections requires the manufacturer to pass the tax on. In this respect the federal admissions tax is different: Section 1715(a) of the 1939 Code required that it be passed on, and Section 1702 required that the price ex tax, and therefore inferentially the tax as well, be separately printed on the ticket. Yet in accounting practice no distinction is drawn between the federal admissions tax, on the one hand, which contains such a requirement, and the federal excise taxes on gasoline (Sec. 3412) and phonographs (Sec. 3404), on the other, which do not. (R. 81.)

However, everyone knows that these excises are customarily passed on, whether legally required to be or not, by the inflexible laws of economics.[4] Congress is not unaware of this. Its entire excise tax program accepts the postulate that its excise taxes are economically consumers' taxes. Accordingly, when it framed Section 3441(a), defining the sales price for those excises which are percentages of the sales price,[5] it provided "but there shall be excluded the amount of tax imposed by this chapter, whether or not stated as a separate charge." Furthermore, when these taxes first became effective, sellers who could not pass the tax on by reason of prior contractual limitations were not taxed; instead the vendee was then taxed. Sec. 3447, 1939 Code.

The nature of both the manufacturers' excises and the beer tax as sales taxes is most clearly revealed, of course, by the floor stocks tax provisions. When these taxes were enacted or increased in 1940 and 1941, floor stocks of goods already manufactured but which were still held for sale by anyone other than the manufacturer were subjected to tax. See, for example, Section 3400(b), 1939 Code. There was also a floor stocks tax on beer in the 1939 Code (Sec. 3191), applicable to beer held for sale on July 1, 1940, by anyone other than the manufacturer. These provisions show that the economic burden of the tax is intended to be on the consumer, and where the

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[4]Due, John F., *Government Finance,* (Irwin, 1954) pp. 281-303; Shultz and Harriss, *American Public Finance* (5th Ed., Prentice-Hall, 1949) pp. 198-212, 223-226; Cf. H. C. Simmons, *Federal Tax Reform,* (Univ. of Chicago Press, 1950) pp. 36-37. Relevant extracts from two of these texts are reproduced in the Appendix.

[5]Such as the excise tax on phonographs and television sets.

normal collection from the manufacturer does not place it so, special adjustments to reach the consumer are enacted. See *S. Strauss & Sons, Inc. v. Coverdale,* (1944) 205 La. 903, 18 So. 2d 496.

The nature of the beer excises as sales taxes also appears from the stipulated (R. 29) fact that "if during the process of bottling, or later, beer was spoiled, was lost, or was sold to another brewer in bond, the amount of the stamps was refundable to taxpayer." This stipulation was based on Sections 3153 and 3154, providing for refund of tax if the product became unsalable.

The essential similarity of these excises as well as of the beer excises to a classical type of sales tax can be seen from a consideration of the excise tax on sales imposed by the California statutes.[6] The statute provides that the tax imposed shall be collected by the retailer from the consumer insofar as it can be done, and makes it a misdemeanor for any retailer to advertise or hold out or state to any customer that the retailer is absorbing the tax or any part thereof or will refund the tax, if it is added to the price.[7] Despite these statutory provisions, it is the established law that the retailer has no right of action against the consumer for the tax unless the consumer has agreed to pay reimbursement for the tax as part of the price and has failed to do so.[8] The

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[6]Revenue and Taxation Code of California, Sec. 6051 et seq.

[7]See ibid., Secs. 6052, 6053.

[8]*Clary v. Basalt Rock Co.,* (1950) 99 Cal.App. 2d 458, 222 P. 2d 24; *Pacific Coast Engineering Co. v. State of California,* (1952) 111 Cal.App. 2d 31, 244 P. 2d 21; Opinion of Attorney General (California), No. 52/178, Dec. 16, 1952, CCH Cal.Tax Cas. No. 200-197; *Livingston Rock & Gravel Co., Inc. v. DeSalvo,* 136 C.A. 2d 156, 288 P. 2d 317.

retailer fails to collect the tax or to contract for reimbursement by the consumer at his peril. He still remains liable for the payment of the tax for, despite the provisions for passing on, the tax is legally a charge upon the retailer and not the consumer.[9] It is clear that the retailer can absorb the tax, i.e., fail to pass it on by collecting it from the consumer, if he sees fit to do so without violating the law. All he cannot lawfully do is to advertise or hold out that he is doing so. This tax is thus legally a retailer's tax, not a consumer's tax, although economically it is passed on to the consumer. Yet in accounting practice the amounts collected as reimbursement from the consumer are excluded by retailers from their gross sales, and therefore from their "gross receipts".[10]

There is, therefore, no basis for a distinction between the beer excise taxes, on the one hand, and gasoline, phonograph excises and retail sales taxes, on the other

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[9]*Meyer Construction Co. v. Corbett,* 7 F.Supp. 616; *People v. Herbert's of Los Angeles,* 3 Cal.App. 2d 482, 39 P. 2d 829; *Western Lithograph Co. v. State Board of Equalization,* 11 Cal. 2d 156, 777, 78 P. 2d 731, 738 (retailers required to pay sales tax on their receipts from retail sales to national banks, even though such banks are assumed to be instrumentalities of the federal government and sales tax on banks as consumers is not authorized by Section 5219, U.S. Revised Statutes).

[10]Economists consider commodity taxes and sales taxes to be alike in their incidence, the former merely being a less generalized form of the latter. Thus Due says (*Government Finance,* p. 281), "A commodity tax may be designed to reach all or a wide range of consumption expenditures or only those made for particular commodities. The former type is known as a *sales tax;* the second type as an *excise tax.*" Both shift directly to the consumer. Due, op. cit., pp. 291, 293. The choice between the two types of taxes is dictated by administrative considerations. Shultz and Harriss, *American Public Finance,* p. 223. Extracts from Due's text are reproduced in the Appendix.

hand. All are intended by the legislative bodies which impose them to be consumers' taxes, all are consumers' taxes in economic effect, and all should be treated alike in their effect on taxpayers' "gross receipts" for measuring growth. Yet the retail sales tax and the excise taxes on gasoline and phonographs are normally excluded in accounting practice from all reports of gross sales. They generally do not appear anywhere in income tax returns. Obviously there is an administrative problem, and a serious one, if the "gross receipts" by which growth is to be measured include figures not shown on the tax returns for the period.

2. Respondent may, however, mean to suggest that the simple solution to the problem is to include in "gross receipts" whatever the taxpayer reported as "gross sales" in its tax returns. (Resp. Br. pp. 15, 24). That would indeed be a simple solution, but not, we think, one Congress could have had in mind. It would not wish two corporations otherwise alike to be taxed differently because of differing methods they adopted of classifying something which, in the years adopted, made absolutely no difference.

3. Respondent also seeks to liken the beer excise taxes to property taxes. The latter, of course, are not commodity taxes, they are not directly passed on to the consumer, and their imposition is not dependent on and postponed until the sale of the property. At least so far as the record shows, there is no practice anywhere of excluding an amount equal to property taxes from gross sales, such as exists for many excises essentially indistinguishable from the beer excises.

In seeking to draw the parallel to property taxes, respondent mistakenly argues (Resp. Br. 24) that petitioner's price scale is independent of the beer excises and does not vary with their amount or with their imposition. The record contradicts respondent. It shows the California beer tax was passed on to the consumer, by comparison of petitioner's California and Nevada prices. The following figures were compiled from the 1948 and 1949 price schedules of the petitioner appended to the Stipulation of Facts as Exhibit IV (not printed per stipulation of the parties):

Product	California Sales Price	Nevada Sales Price	California Beer Tax
24 11-oz. bottles	$1.86	$1.82	$.04
12 32-oz. bottles	2.34	2.28	.06
24 12-oz. cans	2.45	2.41	.04½

The sales invoices for shipments to United States possessions, where neither federal nor state beer taxes apply, show the identical result. These invoices are appended to the Stipulation of Facts as Exhibit III (not printed per stipulation of the parties):

Product	California Sales Price	Sales Price in U. S. Possessions	Federal & California Beer Taxes (in total)	Additional Export Costs
		1947		
24 11-oz. bottles	$1.73	$1.88	$.573	$.72
24 12-oz. cans	2.28	1.69	.625	.03
24 11-oz. non-returnable bottles	2.08	1.58	.573	.03
		1948-1949		
24 12-oz. cans	2.45	1.86	.625	.03
24 11-oz. non-returnable bottles	2.24	1.70	.573	.03

Thus, taking for example the sales of Lucky Lager 12-ounce cans, 24 to the case, in 1948, it is obvious that the basic price of such beer is $1.83 per case before any taxes or extraordinary costs are considered. In shipments to United States possessions where only three cents added export costs are involved, the price is $1.86. However, in shipments to Nevada where the federal tax of 58 cents is applicable, the price is $2.41 ($1.83 plus 58 cents) plus the Nevada state beer tax. Again, when the sales price is figured for California where both the 58-cent federal tax and the 4½-cent state tax are applied, the sales price is $2.45 ($1.83 plus 58 cents plus 4½ cents).

That passing the tax on is not a mere privilege of the petitioner but an economic necessity is immediately apparent when one examines the relationship between petitioner's gross sales plus excise taxes, the tax on the sale of beer (Exhibit II of Stipulation of Facts, not printed per stipulation of parties) and its net income before income taxes as shown by petitioner's United States Corporate Income Tax returns (Exhibit I of Stipulation of Facts, not printed per stipulation of parties), for the years 1946 to 1949, as follows:

Year	Tax Advanced on Beer Sales	Gross Sales Plus Excise Taxes	Net Income (before income taxes)
1946	$ 4,849,076.70	$12,878,751.99	$ 2,101,306.74
1947	5,687,831.75	16,311,138.47	1,927,143.71
1948	5,837,412.88	18,161,135.39	2,359,858.06
1949	7,192,289.27	23,003,696.22	3,838,767.00
Totals	$23,566,610.60	$70,354,722.07	$10,227,075.51

The ratio between the above totals demonstrates that for each $3.00 of gross sales petitioner pays $1.00 in beer

taxes, but has a net income before income taxes of only 44 cents. Simple logic tells us that $1.00 in taxes cannot be absorbed into 44 cents of profit. Absolute business necessity required, therefore, that petitioner be reimbursed for these taxes to remain in business.

Yet, despite the statutory classification of the beer tax as a sales tax and the fact that taxes are passed on to the consumer, the respondent has classified them as costs of production and has concluded from this that the reimbursements therefor are "gross receipts" of petitioner. His conclusion is mistaken, being based on a faulty premise.

4. Respondent has unduly minimized petitioner's rate of growth. He computes it on a volume basis at 23.66% (Resp. Br. 18), whereas the correct figure is over 25%. His error stems from two mistaken presumptions: one, he presumed all petitioner's sales were subject to the federal and California taxes, whereas much beer was sold in other states and was exempt from the latter, and some was sold in export and was exempt from both; two, as the price schedules show, petitioner made no sales in barrels during the base period, all its sales being in bottles and cans, and respondent has presumed barrel sales, whereas the effective rate differs on sales in fractional sizes not for statutory but for practical reasons. A 25% increase is equal to or greater than that Congress would have required absent price increases. See Pet. Op. Br. pp. 31-32. But when petitioner's volume increase, even on the incorrectly low basis calculated by respondent, is adjusted for the price increase which Congress took into account, petitioner's growth becomes 161% when

adjusted for average price increases, and 150.37% when adjusted for petitioner's own price increases.

5. Respondent's main reliance is on *Lash's Products Co. v. United States,* (1929) 278 U.S. 175. We pointed out in our opening brief at p. 48 that Congress had corrected the result reached in that case, and we suggested that for that reason Congress could not be supposed to have meant it to be applied in a statute adopted subsequent to that legislative correction. We also adverted briefly to one point on which that case is to be distinguished. In view of respondent's heavy reliance on that decision, we shall distinguish it now at greater length.

First, the tax in *Lash's Products* was a percentage of the "price for which sold". That phase would certainly be broad enough to include a retailer's California sales tax collections, and even his use tax collections. Under California law, the retailer's right to collect either is one of contract.[11] The buyer pays them to the retailer to get the goods, as part of his purchase price. Yet even respondent seems to agree that a retailer's collections of California use tax are not part of his "gross receipts". (Resp. Br. 16.) The broader scope of the language interpreted in *Lash's Products* is thus evident.

Second, Treasury Regulations which the Court declared it was persuaded had been ratified by Congress required the result reached. Here there is no regulation in point, either old or new.

Third, the regulation specifically provided that the tax on a tax could be avoided by separate billing of the tax,

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[11]See cases cited footnote 8, supra.

and the Court thought that having failed to avail itself of relief contemporaneously afforded by the regulations, the taxpayer was in essence seeking relief from its own neglect. The instant case is different, because in neither the base period (1946-1949) nor any other period were there regulations advising taxpayers how to avoid having tax collections included in their gross receipts. Petitioner's mode of operation was meaningless tax-wise in the base period and essentially what respondent seeks is to give it retroactive significance. This the statute does not do.

6. Respondent apparently recognizes that the interpretation adopted below does not tend to promote uniformity of operation of the statute (cf. Resp. Br. 20-21), but on the contrary leads to discriminations of the kind one should hesitate to impute to Congress. His brief is replete with denials that Congress intended the statute to be an "accurate" test of growth (Resp. Br. 12, 18, 19, 20); respondent prefers that it be called an "objective" test[12] (Resp. Br. 12, 20) rather than an "accurate" one, in order to gloss over the discrimination and lack of uniformity necessarily flowing from his position. See Pet. Op. Br. pp. 34-39, inclusive, for demonstration of this discrimination and lack of uniformity.

Respondent must, of course, argue his case as best he can, and since he cannot deny the discriminatory and ununiform consequences of his position, he probably has no

[12]The term "objective" hardly fits the case, for the statutory formula is to be determined from "subjective" facts, those drawn from each taxpayer's experience, and is to have "subjective" application to the net income of each taxpayer.

alternative but to belittle their significance. But their significance is so great as to be controlling. Even if the literal meaning of the statute were as respondent contends, it would be improperly adopted if it lead to absurd or even unreasonable results. As the Supreme Court said in *United States v. American Trucking Association,* (1940) 310 U.S. 534, 543:

> "When (literal) meaning has led to absurd or futile results, however, this Court has looked beyond the words to the purpose of the act. Frequently, however, even when the plain meaning did not produce absurd results but merely an unreasonable one 'plainly at variance with the policy of the legislation as a whole' this Court has followed that purpose, rather than the literal words."

And as the Supreme Court said, when it commended a lower court for its refusal "to make a fortress out of the dictionary", (*Markham v. Cabell,* (1945) 326 U.S. 404, 409):

> "The policy as well as the letter of the law is a guide to decision. Resort to the policy of a law may be had to ameliorate its seeming harshness or to qualify its apparent absolutes . . ."

This Court said the same thing in different language in *Miller v. Bank of America N.T. & S.A.,* (CA 9, 1948) 166 F. 2d 415, 417. A most recent statement and application of the principle against literalness is in *Maestro Plastics Corporation v. N.L.R.B.,* (1956) 350 U.S. 270, 285. And perhaps the classic expression is in *Harrison v. Northern Trust Co.,* (1943) 317 U.S. 476, 479, like this a tax case, where the Supreme Court said:

> "But words are inexact tools at best and for that reason there is wisely no rule of law forbidding resort to explanatory legislative history no matter how 'clear the words may appear on superficial examination'."

Accordingly, even if the literal words of the statute were as clear as respondent contends, literalness would not suffice. We have demonstrated in our opening brief how the purpose of the statute will be satisfied if petitioner's excess profits are measured by the growth it had attained by 1949, the last year before hostilities began. We have demonstrated how uniformity both geographically and between industries will be prevented by respondent's interpretation and permitted by our own. In the circumstances, under the foregoing authorities of what significance is respondent's avowal of literal support?

7. The foregoing arguments we think answer respondent's search for interpretative material which we do not consider necessary in order to construe the Congressional definition of gross receipts in the case at bar. Respondent has nowhere shown why the phrase "amounts received from the sale or exchange . . . of property" should include amounts received in reimbursement of taxes levied upon the sale of such property in varying amounts and only upon some of the sales.

The respondent has supported himself upon the reed of asserting that if the word "total" is used we are required to blind ourself to the language which describes the amounts which are to be totalled, and cannot be permitted to exclude any amounts. But even that reed must

break under respondent, for he has failed to show that he commands even the literal support of the statue. Under the statute petitioner's gross receipts are "The total amount received or accrued from the sale . . . of stock in trade of the taxpayer or other property, etc." Respondent agrees that petitioner is not in the business of selling taxes, and, therefore, that these taxes are not its "stock in trade" or other qualifying property. (Resp. Br. 15.) Having thus admitted that these taxes are not stock in trade, respondent persists in arguing that the amounts reimbursing petitioner for these taxes are "amounts received from the sale . . . of stock in trade".

Respondent must agree that the taxes are the receipts of the governments to which they are paid, that those governments are the real parties in interest of the taxes, and that petitioner is only their fiscal agent in collecting them. Why, then, should they be *petitioner's* "gross receipts"? This respondent does not explain.

The statute would afford respondent literal support if it said specifically that excise tax reimbursements were includible in "gross receipts". This it does not do. To include them requires an interpolation into the literal language. But the statute defines the taxpayer's gross receipts in language which implies a beneficial receipt by the taxpayer, not a temporary receipt by it as fiscal agent for a government. Even respondent appears to agree that if petitioner collected the California use tax from the consumer, that tax would not be part of *petitioner's* gross receipts. (Resp. Br. 16.)

Literally, then, petitioner draws support from the statute. And the literal wording of the statutes interpreted

in the state cases we cited in our opening brief greatly resembles that herein, thus adding judicial support to our textual analysis.

CONCLUSION.

The decision of the Tax Court, based entirely on a mistaken concept of literal meaning of the statute, erroneously failed to give effect to the purpose of the statute and to give it uniform and reasonable effect. It should be reversed.

Dated, San Francisco, California,
April 23, 1957.

Respectfully submitted,
Russel Shearer,
Arthur H. Kent,
Valentine Brookes,
Counsel for Petitioner.

Rorert H. Heeb,
Of Counsel.

(Appendix Follows.)

Appendix.

Appendix

Due, John F. (Professor of Economics, University of Illinois)—Government Finance, An Economic Analysis (Irwin, 1954), pp. 281-303.

P. 281. "From the standpoint of tax burden, commodity taxes are designed to do indirectly what a spendings tax would do directly, namely, to distribute the cost of governmental activity in proportion to consumption expenditures. Commodity taxes are levied upon the sales (or output) of commodities and collected from the vendors; to the extent that the taxes are reflected in higher prices, individuals are essentially bearing the tax in the form of a tax supplement to the prices of the goods which they are buying and thus in relation to their consumption expenditures.

"A commodity tax may be designed to reach all or a wide range of consumption expenditures or only those made for particular commodities. The former type is known as a *sales tax;* the second type as an *excise tax.*"

P. 291. "These exceptions do not appear to be of sufficient significance to destroy the basic rule: for the most part, any tax on sales or output tends to shift directly to the consumers of the products and is borne primarily in relation to consumer expenditures."

P. 293. "The analysis of the preceding pages is directly applicable to excise taxes. In large measure it is also relevant to the question of the shifting of a sales tax, which in a sense is merely a combination of a wide range of taxes on the sales of particular commodities."

H. S. Simons, *Federal Tax Reform* (University of Chicago Press, 1950), pp. 36-37.

"Fifth Proposal: *Elimination or radical reduction of excise taxes (especially on beer, liquors, tobacco, admissions, etc.) as an element in the federal revenue system.*

"These taxes, to my mind, are the worst elements in our revenue system. They are much more regressive than sales taxes. They are almost wholly concealed, precluding real awareness by individuals of their actual annual burden. They pander to misguided demands for sumptuary legislation, deriving strong support from alleged purposes which they are carefully designed *not* to serve. They pose as levies upon "luxuries," while serving to divert expenditures not from the objects taxed but from "necessities." Like corporation taxes, they are the revenue devices of political cowards who live in terror of voter-taxpayers and of government by intelligent discussion. The only cogent defense of them rests on the Calvinist premise that poor consumers of the objects in question are obviously damned for the next life and may properly be prepared now for their fate, by carrying what would otherwise be tax burdens of the elect."